Share schemes

Long term staff incentives

Guide to share plans

Increasing share ownership is proven to help retain and motivate key staff, aligning them directly to shareholder interests. There are also some potentially substantial tax savings available.

However, there are numerous challenges and ways to structure share participation. This guide will give you an overview of the alternatives.

Shares as a incentive tool

Research in the UK and USA has shown a clear link between employee share ownership and increases in productivity. There is a strong emotional link with the business generated by the sense of 'ownership' that shares can bring, which makes them superior to straightforward cash arrangements for retaining staff. For the directors and senior management of a business there is often a direct link between their actions and the value of the company. By giving the management team a stake in the company they are directly aligned to growing the value of the whole company for the benefit of all shareholders.

Why use a share based reward?

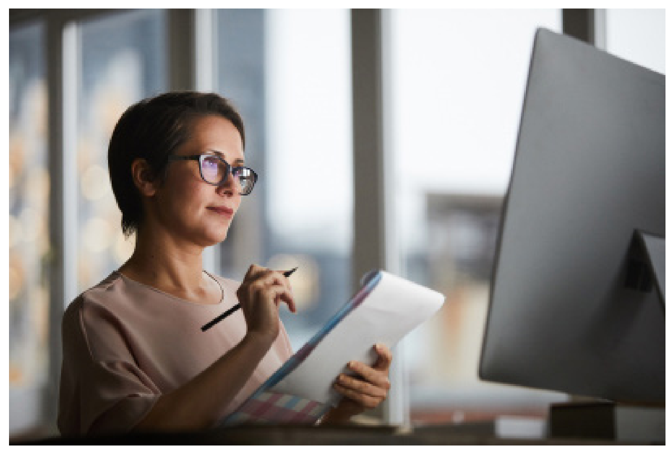
Employers are increasingly using share incentives as a way of rewarding and incentivising employees by giving them a stake in their business. Properly structured, they align employee and shareholder interests and can be powerful tool for recruiting, rewarding and retaining employees, giving them the opportunity to make substantial gains, often in a highly tax efficient manner and funded by external parties rather than the employer.

The direct alignment of reward to growth in shareholder value is a clear and useful incentive mechanism for companies and their shareholders. There are clear advantages in using shares for reward purposes; however, there are numerous challenges.

Picking the right plan

The most common issue we see with share plans is that they are often driven by perceived tax savings rather than the key commercial drivers. Commercial outcomes are not properly considered before implementation. The need to incentivise must be carefully balanced against shareholder interests. Dilution, maintaining control and how the investment will be realised are all important considerations.

Whilst tax savings can be a useful side benefit, a poorly structured share plan can be costly if it drives the wrong behaviour. Getting the right commercial driver is key to getting value from an arrangement.



Share awards and share options

Focus on commercial needs, not the tax wrapper.

- *Which employees/directors will participate and will more join in the future?*
- *What is within their influence?*
- *What does 'good' look like for the company/the individual?*
- *What are the shareholders trying to achieve in the long term?*
- *What are your KPIs?*
- *Will the plan deliver a meaningful value of reward?*
- *How will the participant realise value from the award?*

Share awards and share options

There are numerous ways in which employees can acquire a stake in a business. Which one is right for your business depends upon a variety of factors. There is no 'one size fits all' arrangement and the range of structures open to a company can be bewildering, with different costs, tax consequences and outcomes.

There are many ways of implementing employee share incentives. This brochure outlines some of the more common mechanisms suitable for directors and senior management in private companies. Broadly, arrangements fall into one of three categories: acquiring shares outright, giving employees the right to acquire shares in the future, or a cash bonus arrangement that tracks share price growth.

Whilst they should not be the only or main driver, the potential tax savings should not be overlooked. From a tax perspective, many of the arrangements outlined in this brochure can bring gains within the capital gains tax regime, with attractive tax rates of 20% or less on growth. This is in contrast to bonuses and non-tax advantaged share options, which can attract tax rates of up to 45%, often with 2% employee's and 13.8% employer's national insurance contributions on top.

Share purchase

Arrangements to help employees buy new shares immediately have the advantage that the employee becomes a shareholder from the outset, with the benefit of feeling like an owner of the business. Once the shares are in the employee's hands they can usually benefit from capital gains tax on any growth in value.

These arrangements often revolve around helping employees to manage the initial cost of buying the shares. There are also usually provisions that mean employees forfeit the shares in certain circumstances, e.g. leaving employment before a certain event.

Direct share acquisition

Being able to acquire shares gives an employee an ownership stake in their employing company. It is not unusual for employers to simply grant directors and sometimes senior management the opportunity to buy shares, possibly at a discount.

However, where an employee or director acquires shares in their employer there are a number of tax anti-avoidance provisions to consider. The company will usually also have to consider shareholder protections and leaver provisions. Even with something as seemingly simple as buying shares, advice is therefore recommended.

Purchase on deferred terms

If employees or directors don't have the funds available to buy shares immediately, they can be offered on buy now, pay later terms. This can enable employees to defer the cost until they can afford the shares. Typically the 'loan' (or, more accurately, the outstanding unpaid share capital) might be repaid immediately before the shares are sold.

There are both company law and tax issues that must be managed in much the same way as for any other purchase of shares. However, the biggest difference is that the employee is at risk of the debt being called up if the company gets into difficulty.

Growth shares

'Growth shares' (sometimes referred to as 'flowering shares') are not a statutory arrangement, and so there is no hard and fast definition. Growth shares are typically a class of share, usually created by amending a company's articles of association, which give the holder a stake in the future capital growth of a company but little or no interest in any of the existing value.

The new share class has a right to share in future sale proceeds if the company is sold, but only if the company value has grown.

Growth shares are designed to encourage future high performance, as opposed to rewarding past performance. Growth shares are therefore a popular choice for employers looking to incentivise employees and directors and focus them on growing the company without giving away the hard work put in by the current shareholders.

Share options

Share options are a popular choice for incentivising employees and, broadly speaking, allow the option-holder to purchase a number of shares for a price set today at a point in the future. This can provide an employee or director the opportunity to benefit from growth in the share value, paying today's price, whilst minimising the risk - there are no up-front costs and they don't have to buy the shares if the price has fallen.

A share option is not the same as owning a share - an option carries no rights to receive dividends, nor any right to vote. This can be an advantage for many private companies.

Unapproved options

Share option schemes that don't fall within any of the specific statutory arrangements are frequently referred to as 'unapproved' share options. As they are not statutory arrangements they are potentially very flexible and open to all companies.

Helpfully, there are no tax or national insurance contributions payable on a grant of unapproved share options. This means there are few if any up-front costs for a UK based employee or director receiving such an award. However, when an employee or director exercises the option and acquires shares they will be liable to income tax and potentially both employer's and employees' national insurance contributions on any gains made.

Tax advantaged options

There are four types of statutory tax advantaged share plan. 'Save As You Earn' (SAYE) and 'Share Incentive Plans' (SIP) are all-employee plans generally well suited to listed businesses. 'Enterprise Management Incentive' (EMI) and 'Company Share Option Plan' (CSOP) outlined below are better suited to discretionary awards to directors and senior managers.

EMI

A type of tax advantaged option targeted at SME businesses, EMI plans are nearly as flexible as an unapproved option. However, the company, the recipient and the option itself must satisfy a number of qualifying conditions (e.g. a company must be carrying on a 'qualifying trade' and have fewer than 250 employees). Subject to meeting all of the conditions, the holders of EMI options can enjoy a number of significant tax reliefs.

EMI options are popular, largely due to of the generous tax reliefs available. Gains are generally subject to capital gains tax and there is enhanced access to additional tax reliefs meaning gains on EMI options are often subject to a tax rate of just 10%.

CSOP

Another statutory tax advantaged option plan, a CSOP has many similarities to an EMI option. As with EMI, gains on qualifying CSOP options are exempt from income tax. As a tax advantaged plan, there are a number of requirements that must be met in order to implement a qualifying CSOP scheme.

They tend to be slightly less flexible than an EMI (for example, options must usually be held for at least three years) and the reliefs are slightly less generous. However, there are no restrictions on the size of company that can implement a CSOP option and there are no excluded activities. As such, if your company does not qualify for an EMI arrangement for one of these reasons, exploring whether a CSOP can provide an alternative is often worthwhile.

PKF FRANCIS CLARK
Shared Ambition

Here at PKF Francis Clark we have a dedicated specialist reward team with many years of experience in designing the right solution for your business.

We can help

- *Design plans focused on your commercial needs*
- *Advise on the tax treatment of awards*
- *Carry out valuations*
- *Implement share plans, either in house or in conjunction with your usual legal adviser*

Contact us

If you have any questions on any matter in this brochure please contact your usual PKF Francis Clark contact. Alternatively, call our head of reward, Martin Brown, on 01823 275925 or via email at: martin.brown@pkf-francisclark.co.uk

Our reward team is led by Martin who has 17 years' experience as a Chartered Tax Adviser, the last 13 of which he has spent specialising in providing advice on management share matters. Experience includes: both private and listed companies; advising both owners and directors; start ups to FTSE 100; UK and global companies.

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